IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Augusta Division

IN RE: MICHAEL ROY REAGAN REBECCA G. REAGAN Debtors	)	Chapter 7 Case Number 96-12782
MICHAEL ROY REAGAN REBECCA G. REAGAN Movants vs. A. STEPHENSON WALLACE, CHAPTER 7 TRUSTEE Respondent	)	FILED At 5:00 o'clock & 30 min.P.M. Date: 12-23-97

ORDER

Before the court is the motion of the debtors Michael Roy Reagan and Rebecca G. Reagan to compel the Chapter 7 trustee to turnover $100,000.00 held by him pursuant to an order approving a compromise of a dispute between the debtor, Michael Roy Reagan, and L. Gale Lemerand and Gale Industries, Inc. (hereinafter collectively "Gale defendants"). Based upon the evidence presented at hearing, I issue the following findings and fact and conclusions of law denying the debtors' motion.

The debtors filed this voluntary petition for relief under Chapter 7 of Title 11 United States Code on November 27, 1996. The debtors' filed summary of schedules list liabilities totaling $558,423.85 including $280,406.33 of debt due unsecured creditors and assets totaling $396,020.00. Listed as an asset is a cause of action against the Gale defendants then pending in the United States District Court for the Northern District of Georgia civil action no. 96-CV-0944-ODE. The cause of action filed by the debtor, Michael Roy Reagan, alleges that he and the Gale defendants entered into a written agreement dated August 31, 1994 whereby Mr. Reagan sold to the Gale defendants his Augusta, Georgia based sheet metal business, and further entered into an employment agreement with the Gale defendants. The complaint alleges actual and constructive fraud by the Gale defendants by inducing Mr. Reagan to enter into the agreement, and a breach of the contract between the parties entitling Mr. Reagan to an award of damages. By order filed September 8, 1997 in the civil action between Mr. Reagan and the Gale defendants the Honorable Orinda D. Evans, United States District Judge for the Northern District of Georgia, found

> "[i]n 1994, [Reagan] sold his business to [Gale] defendants pursuant to an Agreement for Sale and Purchase of Business Assets ("Purchase Agreement"). The Purchase Agreement stated that other agreements were being entered into in order to induce [Reagan] to sell his business to [Gale] defendants. One of these agreements was an Employment Agreement and Covenant not to Compete ("Employment

> Agreement”). Under this agreement, [Gale] defendants agreed to employ [Reagan], and [Reagan’s] salary would consist of commissions and additional compensation based upon the future profits of the company. Among other things, the Employment Agreement also provided, “Any dispute arising out of or relating to this agreement or the breach, termination, or validity thereof, . . . may be finally settled by arbitration.” The Purchase Agreement does not contain an arbitration provision. . . . [Reagan] claims that [Gale] defendants’ actions breached duties owed [Reagan] under the Employment Agreement. Additionally, [Reagan] claims that [Gale] defendants fraudulently induced him to enter into the Purchase Agreement by implying that they would operate the business in a profitable manner thus ensuring [Reagan] gainful employment.
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> On August 16, 1996, the court issued an order in which it referred various issues to arbitration. . . . [T]he arbitrator conducted a hearing . . .

By award entered April 17, 1997 the arbitrator found that:

> [d]ue to the breach of the Employment Agreement dated August 31, 1994 by the RESPONDENT, GALE INDUSTRIES, INC. the CLAIMANT [REAGAN] is excused from any further performance of employment duties and non-competition obligations under said Employment Agreement.
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> The respondent, GALE INDUSTRIES, INC. shall pay to the CLAIMANT the sum of Eighty One Thousand Six Hundred Seventy Three and 59/100 ($81,673.59) Dollars, such being inclusive of interest through the date of this award. Interest shall accrue at the Florida post-judgment statutory rate from the date of the award until the sum indicated herein plus accrued post-award interest is paid in full.
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> The Arbitrators’ fees and expenses shall be born by the RESPONDENT GALE INDUSTRIES, INC. The administrative fees of the American

> Arbitration Association shall be born by the RESPONDENT, GALE INDUSTRIES, INC., and shall be paid as directed by the Association.
>
> The claimant is the prevailing party and is entitled to receive his reasonable attorney's fees and costs arising from this Arbitration proceeding from the RESPONDENT GALE INDUSTRIES, INC. The issues of reasonable amounts of attorney's fees and costs shall be determined by a court of law. . . .

According to the September 8 order of Judge Evans, "[o]n May 20, 1997, the court approved the award of the arbitrator and directed the parties to inform the court whether any issues remain for adjudication." The September 8 order denied the Gale defendants' motion to vacate the award of the arbitrator and granted Mr. Reagan's motion as plaintiff to amend his complaint. As there remained causes of action asserted by Mr. Reagan in the lawsuit with the Gale defendants requiring trial, the arbitrator's award as approved by the district court did not conclude the litigation.

By motion filed November 19, 1997 in this court the Chapter 7 trustee, respondent herein, sought approval of a compromise and settlement of all claims between the debtor, the Chapter 7 bankruptcy estate and the Gale defendants for a payment from the Gale defendants of $185,000.00. At hearing held December 4, 1997 this dispute between the Chapter 7 trustee and the debtors initially came before me. The proposed compromise required the debtor, Mr. Reagan, the Chapter 7 trustee, Mr. Wallace, and appointed counsel Calvin A. Rouse, to enter into a settlement agreement with the Gale defendants whereby the Gale defendants would pay over a total of $185,000.00 pursuant to two separate agreements. The terms of the two agreements are essentially as follows: (a) "Release and Settlement Agreement" under which the Gale defendants would pay $85,000.00 to Mr. Reagan and the bankruptcy estate and the parties would consent to the dismissal of the district court civil action and Mr. Reagan would executed a full and complete release of the Gale defendants; and (b) "Non-Competition Agreement" wherein upon the payment by the Gale defendants of $100,000.00 Mr. Reagan agreed not to engage in a competitive business in Augusta, Georgia with that of the Gale defendants for a period of five (5) years from the date of the execution of the agreement.

The parties to this dispute agreed that the settlement is in the best interests of the debtor and the Chapter 7 bankruptcy estate, which was approved by me, and further agreed that $85,000.00 of the settlement was a prepetition asset of the bankruptcy estate. Unresolved and continued for hearing on December 18, 1997 was whether the balance of the money, $100,000.00, was an asset of the bankruptcy estate for administration by the Chapter 7 trustee or a post-petition asset of the debtor.

Although a non-compete agreement in conjunction with or as a part of the sale of a business and the impact of a subsequent bankruptcy proceeding on those agreements are not unusual, the facts of this case are unique and insofar as I can ascertain have not been addressed by a court. The typical facts addressed in a bankruptcy context require determination of whether a <u>prepetition</u> non-compete agreement binding the debtor post-petition with periodic payments extending through the post-petition period is an asset of the bankruptcy estate. The majority of courts addressing this issue have found the non-compete agreement to be such an asset. See, e.g. Andrews v. Riggs Nat'l Bank of Washington, D.C. (In re Andrews), 80 F.3d 906 (4th Cir. 1996)(a prepetition non-competition obligation was not services performed to exclude the obligation pursuant to 11 U.S.C.

§541(a)(6)), In re Andrews, 153 B.R. 159 (Bankr. E.D. Va. 1993)(same); In re McDaniel, 141 B.R. 438, 440 (Bankr. N.D. Fl. 1992) (same); In re Prince, 127 B.R. 187, 192 (N.D. Ill. 1991) (same) aff'd 85 F.3d 314 (7th Cir. 1996); In re Bluman, 125 B.R. 359, 363 (Bankr. E.D.N.Y. 1991) (same). Even though the facts of this case establish that the non-compete agreement approved in the compromise was entered post petition, the non-compete agreement was "inextricably intertwined" with the prior agreement for the sale of the business and was therefore "sufficiently rooted in the pre-bankruptcy past" to constitute property of the debtor's estate. Andrews, 153 B.R. at 164. Mr. Reagan testified that the two agreements approved under the settlement and compromise, one settling the pending litigation and the other providing for a five-year non-competition period were interdependent. The Gale defendants would not settle the pending civil action without a non-compete agreement. Regardless of the form proposed in the compromise, the essence of the settlement is clear. The payment of $185,000.00 is to resolve the pending litigation and to reinstate and extend the non-compete agreement entered prepetition as a part of the sale of the business assets and the employment agreement. The fact that Mr. Reagan is required, as a part of the settlement, to enter into a new non-compete agreement does not render this a post-petition transaction, but merely the reinstatement of the prepetition non-compete agreement voided by the arbitration award. Having determined that the compromise and settlement, including the "new non-compete agreement" are prepetition assets of the bankruptcy estate, and agreeing with the majority position that a payment in exchange for a non-competitive agreement is not "earnings from services performed" as required under §541(a)(6)[1], the entire

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[1] 11 U.S.C. §541(a)(6) provides:

> The commencement of a case under Section 301, 302, or 303 of this Title [11] creates an estate. Such estate is comprised of all of the following property wherever located and by whomever held:

$185,000.00 paid as a part of the compromise and settlement is an asset of the

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> (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of case. . . .
>
> (6) Proceeds, products, offspring, rents, or profits of and from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case. . . .

bankruptcy estate for administration by the Chapter 7 trustee.[2]

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[2]As an additional claim raised at hearing, the debtor contends that, post petition, he has either paid in full or compromised all but $3,636.00 in unsecured debt contending that this, plus the required administrative expenses associated with this amount of debt is all that is required by the Chapter 7 trustee. As noted previously, the debtors' schedules list unsecured debt of $280,406.33 and as of the date of the hearing, December 18, unsecured claims totaling $24,664.50 have been filed with a claims bar date of February 17, 1998. Although there may be significantly less unsecured debt remaining, the exact amount cannot be determined until the claims allowance process is concluded.

It is therefore ORDERED that the debtors' motion to require the Chapter 7 Trustee to turnover money to the debtor is denied.

JOHN S. DALIS
CHIEF UNITED STATES BANKRUPTCY JUDGE

Dated at Augusta, Georgia

this 23rd day of December, 1997.